No. 9817

United States
Circuit Court of Appeals
For the Ninth Circuit

ISIDORE WINKLEMAN, alleged bankrupt,
Appellant,

vs.

T. OGAMI, MESAL BAG COMPANY, PORTLAND BAG AND METAL COMPANY and ENKE'S CITY DYE WORKS, INC.,
Appellees.

Appellant's Brief

Upon Appeal from the District Court of the United States, for the District of Oregon.

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STATUTES

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STATEMENT OF JURISDICTION

This is an appeal from an order of the United States District Court for the District of Oregon, adjudicating the appellant a bankrupt upon an involuntary petition. (Tr. 2).

The Acts of Congress relating to Bankruptcy, commonly known as the Bankruptcy Act, specifically give to the several "Courts of Bankruptcy" jurisdiction to adjudge persons bankrupt.

Courts of Bankruptcy are defined by the Bankruptcy Act:

> "Courts of Bankruptcy" shall include the District Courts of the United States and of the Territories and possessions to which this title is or may hereafter be applicable, and the District Court of the United States for the District of Columbia;" *Title* 11, *Section* 1 (10) *U. S. C. A. as amended.*

The jurisdiction of the several District Courts of the United States in Bankruptcy is provided in the Bankruptcy Act as follows:

> "The Courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law, and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—
>
> (1) Adjudge persons bankrupt who have had their principal place of business, resided or had their domicile within their respective territorial jurisdictions for the preceding six months, or for a longer portion of the

preceding six months than in any other jurisdiction, or who do not have their principal place of business, reside, or have their domicile within the United States, but have property within their jurisdictions, or who have been adjudged bankrupts by courts of competent jurisdiction without the United States, and have property within their jurisdictions;" *Title* 11, *Section* 11, *a, U. S. C. A. as amended.*

The Circuit Court of Appeals by virtue of the following express provisions of the Bankruptcy Act, has appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings or controversies in bankruptcy.

"The Circuit Court of Appeals of the United States and the United States Court of Appeals for the District of Columbia, in vacation, in chambers, and during their respective terms, as now or as they may be hereafter held, are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy, either interlocutory or final, and in controversies arising in proceedings in bankruptcy, to review, affirm, revise, or reverse, both in matters of law and in matters of fact: Provided, however, That the jurisdiction upon appeal from a judgment on a verdict rendered by a jury, shall extend to matters of law only: Provided further, That when any order, decree, or judgment involves less than $500, an appeal therefrom may be taken only upon allowance of the appellate court." *Title* 11, *Section* 47, *a, U. S. C. A. as amended.*

In the present case the jurisdiction of the United States District Court for the District of Oregon and the appellate jurisdiction of this court, in light of the foregoing provisions of the statute, is clear.

STATEMENT OF THE CASE

An involuntary petition in bankruptcy was filed in the United States District Court for the District of Oregon against Isidore Winkleman, the alleged bankrupt (Appellant herein). The petition was filed solely by T. Ogami and contained averments that the alleged bankrupt had creditors less than twelve in number. (Tr. 2). Pursuant to the statute, the alleged bankrupt filed his answer to the involuntary petition and scheduled his creditors, which schedule showed that his creditors exceeded twelve in number. Subsequently there were filed petitions in intervention by the Portland Bag & Metal Company, Mesal Bag Company and Enke's City Dye Works, Inc., who were other creditors of the alleged bankrupt, and who joined in the petition. (Tr. 2). The alleged bankrupt filed his answer to each of the intervening petitions and contended "that the original petitioning creditor and the intervening petitioning creditors, and each of them, had received preferences which they had not returned or offered to return in their petitions." (Tr. 3).

At the trial it was stipulated that Enke's City Dye

Works, Inc., one of the intervening petitioning creditors, was qualified to join in the petition as a petitioning creditor and has a provable claim. No evidence was offered to support the provability of the claim of Mesal Bag Company or that said creditor was qualified to join in the petition. Evidence was offered in support of the alleged bankrupt's claim that T. Ogami, the original petitioning creditor, and the Portland Bag & Metal Company, the intervening petitioning creditor, had received voidable preferences and failed to offer to return them in the petitions. (Tr. 3).

The trial court rendered its opinion and held that whether the petitioning creditor and intervening creditor had received preferences and had failed to offer to return them was not an issue in the cause and, accordingly, it did not consider the evidence offered in support thereof. (Tr. 4). The court further held that the allegations contained in the original petition filed by T. Ogami and the intervening petitions of Portland Bag & Metal Company and Enke's City Dye Works, Inc., had been sustained by evidence and that in accordance with the statute three or more creditors had joined in the petition, and based upon its holding it made and entered its order of adjudication on March 5, 1941. (Tr. 6).

From this order of adjudication the alleged bankrupt, feeling aggrieved, has commenced the present appeal. (Tr. 7).

There has been filed as the record in this cause an Agreed Statement of the Case under Rule 76, Rules of Civil Procedure, duly agreed to by all the parties hereto and certified to by the United States District Judge as being a complete statement of a sufficient portion of the pleadings, evidence and proceedings in the within cause to fully present to this court the questions and points raised on the appeal herein. (Tr. 2-8).

THE QUESTION INVOLVED

The sole question involved is whether or not a creditor who has received a voidable preference can be counted in an involuntary petition in bankruptcy as one of the petitioning creditors without surrendering or offering to surrender the preference received by him.

SPECIFICATION OF ERROR TO BE RELIED ON

The District Court erred in making and entering its order adjudicating the appellant a bankrupt without first determining from the evidence whether or not T. Ogami, original petitioning creditor, and Portland Bag & Metal Company, intervening petitioning creditor, received preferences and offered to surrender said preferences received by them.

POINTS AND AUTHORITIES

A creditor who has received a voidable preference cannot be counted as one of the petitioning creditors upon an involuntary petition without surrendering or offering to surrender the preference received by him.

In re Fishblatt, 125 Fed. 986; 11 Am. B. R. 204.

Stevens v. Nave McCord Co., 150 Fed. 71; 17 Am. B. R. 609.

Matter of John F. Murphy, 225 Fed. 392, 35 Am. B. R. 635.

Matter of Standard-Detroit Tractor Co., 275 Fed. 952; 47 Am. B. R. 642.

In the Matter of Macklem, 22 Fed. (2d) 426; 10 Am. R. B. (N. S.) 550.

Matter of Phillips & Co., Inc., 28 Fed. (2d) 299; 12 Am. B. R. (N. S.) 312.

Brehme v. Watson, 67 Fed. (2d) 359; 24 Am. B. R. (N. S.) 166.

Vol. 1 *Remington on Bankruptcy,* Page 368, section 258.

Vol. 2 *Collier on Bankruptcy,* Page 1217, 1218.

Section 59b, Bankruptcy Act.

Section 59e, Bankruptcy Act.

ARGUMENT

In his answer the alleged bankrupt contended that the petitioning creditors, and each of them, had received preferences and had not surrendered them or offered to surrender them in their petitions. At the trial of this cause,

it was admitted that one of the creditors, Enke's City Dye Works, Inc., had a provable claim and was qualified to join in the petition. Another creditor, the Mesal Bag Company, did not offer any proof in support of its claim and its qualification as a petitioning creditor, and therefore cannot be considered as having joined in the petition. (Tr. 3). Evidence was submitted to support the alleged bankrupt's contention that the other two creditors who had joined in the petition, T. Ogami and Portland Bag & Metal Company, had each received preferences within four months prior to the filing of the petition. The appellant contended that these preferences were voidable under the Bankruptcy Act and that each of these creditors had failed to surrender such preferences or failed to offer to surrender such preferences in their petition. Accordingly, if the appellant's contention that the above described creditors had received preferences is sustained, these creditors having received voidable preferences, are not to be counted in determining the number of creditors who have joined in the petition. If appellant prevails, the petition must fail as there remains only one qualified creditor, the Enke's City Dye Works, Inc. The District Court heard the evidence offered to prove that the petitioning creditors had received preferences and that said creditors had refused to surrender or offer to surrender them, but in its opinion the court held that this matter was not an issue in the proceeding.

The rule has been well settled by the weight of authority existing prior to the enactment of the Chandler Act that a creditor who holds a preference, while he may join in the petition if he has a provable claim, cannot be counted as one of the required number of creditors who may join in the petition without first surrendering or offering to surrender in the petition the preference so received by him. The most recent expression of this rule is found *In the Matter of Macklem,* 22 Fed. (2d) 426; 10 Am. B. R. (N. S.) 550. In this decision it appears that an involuntary petition for an adjudication of a bankrupt was filed by three creditors. The alleged bankrupt answered the petition and, among other things, contended that the petitioning creditors had been preferred within four months of the filing of the petition and that accordingly they were disqualified to act as petitioning creditors. The court sustaining this contention in its opinion, held: (Italics ours).

> "As to the matter of disqualification of the three petitioning creditors, the Bankruptcy Act, section 59 (b) provides that 'three or more creditors who have provable claims against any person * * * may file a petition to have him adjudged a bankrupt.' Under some of the decisions, 'provable' is held to mean any claim which might be proved, whether preferred or not; while other cases hold that it is the aquivalent of 'allowable'. See In re Standard-Detroit Tractor Co., (D. C. Mich.), 47 Am. B. R. 642, 275 F. 952, 954. *But the weight of authority is that a creditor who has received a voidable preference may still join in the petition, though he may*

not be counted as one of the required three petitioning creditors unless he surrenders his preference. Stevens v. Nave McCord Co., (C.C.A., 8th Cir.) 17 Am. B. R. 609, 150 F. 71; In re Gillette (D. C., N. Y.), 5 Am. B. R. 119, 104 F. 769; Canute S. S. Co. v. Pittsburgh Coal Co., 263 U. S. 244, 2 Am. B. R. (N. S.) 231, 44 S. Ct. 67, 68 L. ed. 287; In re Cooper (D. C. Mass.) 7 Am. B. R. (N. S.) 643, 12 F. (2d) 485. As was said in the Stevens case:

"* * * The evil of preferences which the bankrupt law was enacted to remove, the remedy of an equal distribution of the property of the bankrupt which it was passed to provide, the prohibition of the use of their claims by preferred creditors until they surrender them, which the act contains, the general scope of the law and all its provisions read and considered together, and the duty to give to it a rational and sensible interpretation, have forced our minds to the conclusion that it was the intention of Congress that creditors who hold voidable preferences should not be counted either for or against the petition for an adjudication in bankruptcy until they surrender their preferences. This intention, thus deduced, must therefore prevail over the technical rules of construction which counsel for the appellees invoke. *The result is: A creditor who holds a voidable preference has a provable claim in the sense that he may make and file the formal proof thereof specified by the bankruptcy law; but he may not procure an allowance of his claim, he may not vote at a creditors' meeting, and he may not obtain any advantage from his claim in the bankruptcy proceeding before he surrenders his preference.*

Such a preferred creditor may present or may join in a petition for an adjudication of bankruptcy. *But he*

may not be counted for the petition unless he surrenders his preference before the adjudication. In re Hornstein (D. C. N. Y.), 10 Am. B. R. 308, 122 F. 266, 273, 277; In re Gillette (D. C. N. Y.) 5 Am. B. R. 119, 104 F. 769."

For additional authorities in support of the foregoing rule, see: *Matter of Phillips & Co Inc.,* 12 Am. B. R. (N. S.) 312; 28 Fed. (2d) 299; *Stevens v. Nave McCord Co.,* 150 F. 71; 17 Am. B. R. 609; *Matter of Standard-Detroit Tractor Co.,* 275 Fed. 952; 47 Am. B. R. 642; *Matter of John F. Murphy,* 225 Fed. 392; 35 Am. B. R. 635; *In re Fishblatt,* 125 Fed. 986; 11 Am. B. R. 204; *Vol.* 1 *Remington on Bankruptcy,* page 368, Section 258; *Vol.* 2 *Collier on Bankruptcy,* Page 1217, 1218.

In Volume 1, *Remington on Bankruptcy,* 1940 Supplement, page 40, the author states that this court has impliedly held in *Brehme v. Watson,* 67 Fed. (2d) 359, 24 Am. B. R. (N. S.) 166, that a creditor holding an attachment lien secured within four months immediately preceding the filing of a petition in bankruptcy cannot join in such petition without first surrendering his lien.

The foregoing rule has been well established prior to the enactment of the Chandler Act, and said rule has not been altered or changed by the amendatory provisions of this Act. A comparative analysis of the pertinent sections of the Bankruptcy Act as they existed prior to the Chandler Act and after the amendment by virtue of said act discloses: (Italics indicate Chandler Act amendment)

CHANDLER ACT

(Section 59b, Bankruptcy Act)

"Three or more creditors who have provable claims *fixed as to liability and liquidated as to amount* against any person which amount in the aggregrate in excess of the value of securities held by them, if any, to $500 or over; or if all of the creditors of such person are less than twelve in number, then one of such creditors whose claim equals such amount may file a petition to have him adjudged a bankrupt."

* * *

(Section 59e, Bankruptcy Act)

"In computing the number of creditors of a bankrupt for the purpose of determining how many creditors must join in the petition, there shall not be counted

(1) such creditors as were employed by the bankrupt at the time of the filing of the petition;

(2) creditors who are relatives of the bankrupt, *or, if the bankrupt is a corporation, creditors who are stockholders or members, officers or members of the board of directors or trustees or of other similar controlling bodies of such bankrupt corporation;*

(3) *creditors who have participated, directly or indirectly, in the act of bankruptcy charged in the petition;*

(4) *secured creditors whose claims are fully secured; and*

(5) *creditors who have received preferences, liens, or transfers void or voidable under this Act.*"

OLD ACT

(Section 59b, Bankruptcy Act)

"Three or more creditors who have provable claims against any person which amount in the aggregate, in excess of the value of securities held by them, if any, to five hundred dollars or over, or if all of the creditors of such person are less than twelve in number, then one of such creditors whose claim equals such amount may file a petition to have him adjudged a bankrupt."

* * *

(Section 59e, Bankruptcy Act)

"In computing the number of creditors of a bankrupt for the purpose of determining how many creditors must join in the petition, such creditors as were employed by him at the time of the filing of the petition or are related to him by consanguinity or affinity within the third degree, as determined by the common law, and have not joined in the petition, shall not be counted."

It appears clear that the only amendment to Section 59b of the Bankruptcy Act is the requirement that the claim of the creditor joining in the petition must be fixed as to liability and liquidated as to amount. This amendment was apparently made to avoid the necessity of liquidating, estimating and determining claims of petitioners which might be contingent or unliquidated and thus the trial of a contested petition would be expedited. It thus appears that the amendment to Section 59b does not alter or change the rule that existed under the old act.

Section 59e, subsection (5) of the Chandler Act specifically excludes in the count to determine whether the requisite number of creditors have joined in the petition "creditors who have received preferences * * *." The Chandler Act now clarifies and codifies the rule that had been established prior thereto. It clearly expresses the intent of Congress to require preferred creditors to surrender their preferences prior to being counted as petitioning creditors. It is interesting to note that in an early leading case enunciating this rule prior to the amended act (*Stevens v. Nave McCord Co.,* 150 F. 71; 17 Am. B. R. 609), there was a complete and thorough discussion of the reasons why a preferred creditor should not be counted in a petition without first surrendering his preference.

In the court's opinion it states that one of the arguments advanced by one of the preferred petitioning creditors was that the act then existing did not in any manner preclude preferred creditors from being counted in determining whether the requisite number of creditors had joined in the petition. Notwithstanding this contention the court adhered to the rule that the preferred creditor must first surrender or offer to surrender his preference before he may be counted as a petitioning creditor. Furthermore, under the amended Bankruptcy Act (Chandler Act) this argument is set at rest by virtue of the specific statutory exclusion of creditors who hold preferences from being counted as one of the required number who may join in a petition. (Section 59e (5) Bankruptcy Act).

The spirit and intent of the Bankruptcy Act throughout is to afford an equal distribution of the property of the bankrupt to all creditors, and it is only reasonable to expect that one who has received such a preference should surrender the preference or offer to surrender the same if he desires in any manner to seek the aid of the Act. If a preferred creditor may join in a petition without surrendering or offering to surrender his preference, he has an advantage over other creditors which advantage he retains in spite of the fact that he is at-

tempting to invoke the aid of the Bankruptcy Act in adjudicating the debtor a bankrupt. A bankruptcy proceeding is an equitable proceeding. Preferred creditors refusing to surrender their preference run afoul of the ancient equitable maxim *"he who comes into equity must come with clean hands."* It is manifestly unfair to subject all of the debtor's other creditors to the risk of having their debts discharged without receiving a ratable distribution of the debtor's assets. The act in many instances specifically precludes preferred creditors from acquiring certain rights thereunder without surrendering their preferences. For example, a preferred creditor cannot vote at meetings of creditors (Section 56b Bankruptcy Act); preferred creditors cannot have their claims allowed unless they surrender their preferences (Section 57g Bankruptcy Act).

CONCLUSION

The rule as adopted by many courts requiring a preferred creditor to surrender or offer to surrender his preference before being counted as a petitioning creditor is well established. The Chandler Act does not in any manner alter or change this rule and as a matter of fact codifies the old rule. Accordingly, it should be clear that

the District Court erred in failing to determine whether the petitioning creditors had received preferences. The order of adjudication should be reversed.

Respectfully submitted,

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